

ARE CORPORATE GOVERNANCE CODE DISCLOSURE AND ENGAGEMENT PRINCIPLES EFFECTIVE VEHICLES FOR CORPORATE ACCOUNTABILITY? THE UNITED KINGDOM AS A CASE STUDY

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Disclosure and engagement principles are included in every corporate governance code, reflecting a critical emphasis on communication as a vehicle for corporate accountability. These communication principles have been a focus of reform worldwide, prompted by shifts in financial market and social expectations of corporations. The article examines the disclosure and engagement provisions in the Corporate Governance Code in the United Kingdom (and the proposed reforms to these provisions) as a case study. The proposed initiatives seek to strengthen the voice of employees and enhance disclosure around environmental and social concerns. However, this article contends that the gains achieved from these reforms may be marginal due to structural deficiencies. The incremental disclosure and engagement obligations are expected to be flexible and loosely phrased, with a negligible probability of significant market consequences or regulatory intervention. Moreover, most substantive corporate communication will continue to occur at private forums between directors and selected institutional investors. In financial markets with these regulatory settings, effective governance mechanisms to ensure broad and independent accountability of corporations are lacking or weak. Indeed, these legal structures encourage and legitimise carefully differentiated private and public communication channels, with the public discourse used to present a sparkling company image. Policy makers need to re-consider their reliance on private forums to improve governance standards and ensure that public communication frameworks are inclusive, responsive, probative and enforced. In this way, company law will start to meet the growing calls for corporates to act as responsible citizens.

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I INTRODUCTION

[C]ontemporary moves toward more socially responsible corporations have focused especially on three goals associated with the desire for greater ‘publicness’ in powerful institutions (corporate and otherwise): more transparency via disclosure; increased accountability in decision-making processes; and greater voice in those processes for affected persons. These usually take the form of governance reform, rather than substantive requirements.¹

The *Cadbury Report* in the United Kingdom (UK) prompted the introduction of corporate governance codes around the world and sets the objectives and tone of modern corporate disclosure and engagement law and debate.² This seminal report indicates that the key principles of modern corporate governance codes are openness, integrity and accountability, and these factors are interdependent.³ The primary mechanism identified to achieve these objectives is disclosure, and the board of directors is held responsible for reporting quality information.⁴ Similarly the *G20/OECD Principles of Corporate Governance* (OECD Principles) rely on disclosure as the primary mechanism to 1) promote effective communication between listed corporations and outsiders, 2) ensure corporate boards are held to account, and 3) drive corporate outcomes that satisfy public interest objectives including efficient investment and financial markets, economic growth, and public trust and confidence in the business sector.⁵

National corporate governance codes consistently contain disclosure and engagement principles and the orthodox model supporting these communication recommendations is one of responsive dialogue between corporate boards and shareholders.⁶ Nevertheless, as calls grow for corporations to become responsible citizens in society, demands for company information and access to corporate executives are increasing and the

¹ Donald C Langevoort, ‘Cultures of Compliance’ (2017) 54 *American Criminal Law Review* 933, 963.

² *Report of the Committee on the Financial Aspects of Corporate Governance* (1 December 2012) [3.5] (‘*Cadbury Report*’) <<http://www.ecgi.org/codes/documents/cadbury.pdf>>.

³ *Ibid* [3.5].

⁴ *Ibid* [4.5].

⁵ OECD, *G20/OECD Principles of Corporate Governance* (30 November 2015) OECD iLibrary <https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en>.

⁶ Corporate governance codes are generally encompassed within listing rules that companies contractually agree to abide by when they list on an exchange. However, most of these codes are supported by legislated provisions and the NYSE *Corporate Governance Code* contains mandatory provisions.

commercial and regulatory settings are shifting.⁷ Recent reforms of corporate governance codes (including proposed reforms) typically provide for additions to recommended reporting content and a broadening of the engagement processes to include key stakeholders, such as employees.⁸ These features are reflected in the proposed reforms to the UK corporate governance code and are reviewed in this article as a case study. While some of the specifics of the corporate governance framework in the UK reflect local conditions, many of the concerns prompting the reform agenda are replicated in other jurisdictions. The proposed reforms are relevant in Australia because governance developments in the UK are an important influence on regulation here.⁹ Most of the principles laid down in the *Cadbury Report* are reflected in the Australian corporate governance code¹⁰ and issues concerning the environmental and social responsibilities of Australian companies and the rights and remedies of stakeholders are ongoing and highly contested.¹¹

The primary purpose of corporate governance is ‘to help build an environment of trust, transparency and accountability necessary for fostering long term investment, financial stability and business integrity, thereby supporting

⁷ See, eg, Jeroen Veldman, Filip Gregor and Paige Morrow, ‘Corporate Governance for a Changing World: Report of a Global Roundtable Series’ Frank Bold and Cass Business School 18, 52 <http://www.purposeofcorporation.org/corporate-governance-for-a-changing-world_report.pdf>. Corporate leaders who participated in a series of global forums suggested that ‘the role of corporate governance is not only to protect the corporation but to ensure that a corporation is able to create value for society at large.’ See also United Nations Global Compact-Accenture Strategy CEO Study <<https://www.accenture.com/au-en/insight-un-global-compact-ceo-study>>. For the purposes of this article, the terms corporate responsibility, corporate social responsibility and corporate citizenship are treated as interchangeable.

⁸ See, eg, Gill North, ‘Corporate Management and Reporting of Environmental and Social Matters in New Zealand: The Rules, Evidence and Analysis’ (2018) 23 *New Zealand Business Law Quarterly* 240; Gill North, ‘Corporate Management and Communication of Environmental and Social Risks in Australia: Pressures Are Mounting’ (2018) *Australian Journal of Corporate Law* forthcoming).

⁹ Australian Institute of Company Directors, ‘UK Governance Reforms’ (20 October 2017) <<https://aicd.companydirectors.com.au/advocacy/governance-leadership-centre/external-environment/uk-governance-reforms>>.

¹⁰ ASX Corporate Governance Council, *ASX Corporate Governance Principles and Recommendations* (3rd ed, 2014) Australian Stock Exchange <<https://www.asx.com.au/regulation/compliance/compliance-downloads.htm>>.

¹¹ This article does not seek to provide comparative analysis with the Australian position. Instead, the governance rules in Australia regarding corporate disclosure and engagement on environmental and social matters are discussed in Gill North, ‘Corporate Management and Communication of Environmental and Social Risks in Australia’, above n 8. See also Governance Institute of Australia, ‘Shareholder Primacy: Is There a Need for Change’ (Discussion Paper, 2014); Noel Hutley and Sebastian Hartford-Davis, The Centre for Policy Development and the Future Business Council, ‘Climate Change and Directors’ Duties’ (Memorandum of Opinion, 7 October 2016).

stronger growth and more inclusive societies'.¹² While these aims are laudable, this article suggests the long-term gains resulting from recent corporate governance reforms may be limited due to structural deficiencies. The most significant structural concerns are: first, an increasing reliance by company boards on non-public forms of disclosure and engagement; second, market and legal governance processes that fail to address significant conflicts of interest; and, third, negligible market and legal consequences when corporate disclosure and engagement standards and practices are inadequate. To illustrate these structural issues, the article examines the disclosure and engagement provisions in the corporate governance code in the UK¹³ and the proposed reforms.

In the UK and elsewhere, many listed company boards use private meetings with institutional participants as their main channel of communication,¹⁴ and policy makers continue to encourage these meetings on the assumption that adopting this form of dialogue is the best way to optimise corporate governance standards.¹⁵ The article argues that advocates of these private corporate communication and governance models are failing to holistically consider the inherent risks and long term adverse effects on corporations, financial markets, and nations. Many corporations use private forums to convey necessary information to selected institutional participants for procedural, security valuation, and capital raising purposes. Whilst this communication is beneficial for those involved, these carefully tiered structures can result in low quality public disclosures and highly restricted opportunities for other investors and stakeholders to engage with the board (either face-to-face or virtually). In the UK, and in most other major jurisdictions, the corporate governance code principles are supported by statutory and listing rule disclosure and engagement requirements. But when these broader regulatory frameworks allow (and even encourage) use of private forums for comprehensive dialogue with a small pool of investors, the lines between voluntary and mandatory disclosure environments become indistinct, raising serious questions concerning the purpose, legitimacy, and efficacy of the legal structures.

The second Part of the article summarises the rationales for inclusion of disclosure and engagement provisions in corporate governance codes. Part III considers the operation of corporate disclosure and engagement governance

¹² OECD, *Principles of Corporate Governance*, above n 5, 7.

¹³ Financial Reporting Council, *The UK Corporate Governance Code* (April 2016) <<https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>>.

¹⁴ See, eg, Steve Johnson, 'FSA Crackdown on Cash for CEO Access', *Financial Times* (online), 5 March 2013 <<https://www.ft.com/content/084a4bdc-84db-11e2-891d-00144feabdc0>>.

¹⁵ Financial Reporting Council, above n 13, 22.

structures. Part IV narrows the geographical focus and discusses the disclosure and engagement provisions in the *Corporate Governance Code* in the UK (UK Code). Part V explores the efficacy of the UK company disclosure and engagement governance frameworks. The article highlights the high levels of discretion in the regulation concerning the form, scope, and recipients of company disclosures and engagement; the absence of likely significant market or regulatory interventions; and the continued policy encouragement of, and emphasis on, private communication channels. The article concludes that the disclosure and engagement obligations in the corporate governance framework in the UK are weak and fail to adequately promote the objectives of transparency, accountability, trust, inclusiveness and sustainability.¹⁶

II CORPORATE GOVERNANCE CODES: RATIONALES FOR INCLUSION OF DISCLOSURE PRINCIPLES

The legal and governance architectures of companies registered under incorporation statutes are built on the assumption that boards are accountable and will provide high quality information to enable shareholders (and to a lesser extent others) to make well informed decisions and engage with the company regarding its conduct and performance.¹⁷ For example, paragraph 3.2 of the *Cadbury Report* indicates that

Openness on the part of companies, within the limits set by their competitive position, is the basis for the confidence which needs to exist between business and all those who have a stake in its success. An open approach to the disclosure of information contributes to the efficient working of the market economy, prompts boards to take effective action and allows shareholders and others to scrutinise companies more thoroughly.

¹⁶ Corporate sustainability is defined by the United Nations Global Compact (UNGC) as starting with a company's value system and a principled approach to doing business, wherever a company has a presence. The UNGC suggests the rationale for adopting a corporate culture of integrity and business strategies, policies and procedures that satisfy minimum standards in the areas of human rights, labour, environment and anti-corruption is to set the stage for long-term success: UNGC, 'The Ten Principles of the UN Global Compact' <<https://www.unglobalcompact.org/what-is-gc/mission/principles>>. The UNGC is the most prominent corporate sustainability initiative, with 9000 companies and 4000 non-businesses signatories.

¹⁷ For an historical outline, see Gill North, 'Public Company Communication, Engagement and Accountability: Where Are We and Where Should We Be Heading?' (2013) 31 *Company and Securities Law Journal* 167. See also New York Stock Exchange, NYSE: *Corporate Governance Guide* vi; The New York Stock Exchange proudly states that it has required companies to provide financial statements and annual reports to shareholders since the 1890s.

The importance of effective company reporting is highlighted repeatedly throughout the *Cadbury Report*. Paragraph 4.48 describes transparency and information as the lifeblood of financial markets, and paragraph 4.50 confirms the need for company boards to present a balanced, understandable and coherent narrative within reports and disclosures.

Similar themes are highlighted in the OECD Principles, which contain the international standards for modern corporate governance.¹⁸ The OECD Principles confirm that disclosure obligations operate as a tool to influence the behaviour of companies, protect investors, attract capital, and maintain confidence in capital markets.¹⁹ These obligations are deemed necessary because instances of poor and inadequate disclosure commonly reflect unethical behaviour and a lack of integrity, and can result in undue costs to the relevant companies, their shareholders, and the broader economy.²⁰ The OECD Principles acknowledge that effective consultation with the public is an essential element of a successful corporate governance framework.²¹

Within legal scholarly circles, debates concerning the rationales and benefits of corporate disclosure regimes still rage.²² In the meantime, the world has moved on and most countries have adopted corporate disclosure regimes that include periodic reporting and continuous disclosure obligations.²³ Many scholars support mandatory company disclosure on a single basis such as market efficiency or good governance, while not accepting other rationales such as market fairness or sustainability.²⁴ Other commentators suggest that the rationales underpinning existing disclosure regimes are multifaceted and

¹⁸ OECD, *Principles of Corporate Governance*, above n 5.

¹⁹ *Ibid* 38.

²⁰ *Ibid*.

²¹ *Ibid* 13.

²² For discussion on the scholarly literature on mandatory company reporting regimes, see Gill North, 'Timely Public Disclosure of Company Information: A Likely Precondition for Optimal Long-Term Corporate and National Outcomes' (2014) 32 *Company and Securities Law Journal* 560.

²³ Gill North, *Effective Company Disclosure in the Digital Age* (Kluwer Law International, 2015). This book provides an overview of the periodic reporting and continuous disclosure regimes in the United States, Canada, Germany, the United Kingdom, Japan, Hong Kong, Australia and Singapore.

²⁴ See, eg, Financial Reporting Council, *The UK Stewardship Code* (September 2012) <<https://www.frc.org.uk/investors/uk-stewardship-code>>. The UK *Stewardship Code* was introduced in 2010 on a comply or explain basis.

interconnected, and difficult to meaningfully dissect.²⁵ As the Institute of Directors in New Zealand (the Institute) notes:

[g]ood corporate reporting supports good corporate governance and the underlying principles of accountability, transparency, probity and long-term business sustainability. Thoughtful reporting focused on performance also promotes shareholder and stakeholder confidence and trust.²⁶

Although company disclosure regimes are limited in effect and not a panacea to solve every issue arising in financial markets, these regimes provide essential foundational support within commercial and regulatory structures and should be designed and supervised to work optimally.

III HOW CORPORATE GOVERNANCE DISCLOSURE AND ENGAGEMENT PRINCIPLES OPERATE

Most corporate governance codes around the world require listed companies to fully comply with the code recommendations or explain why they have not done so (referred to as a ‘comply or explain’ approach).²⁷ The comply-or-explain approach is intended to provide policy makers and financial market participants with sufficient flexibility to develop tailored rules, structures and practices that are suitable for the circumstances of individual corporations.²⁸ National corporate governance codes comprise a hierarchy of principles with markedly varying degrees of specificity. Competitive pressures for companies to provide a ‘clean bill of health’ have resulted in a predominant focus on the more specific code principles. For example, principles in corporate governance codes that have prompted significant change internationally include the principle, expressed in recommendations or requirements, that a majority of independent directors should be maintained, and that audit and compensation committees should be established. These principles are highly prescriptive, and companies have little discretion when indicating their compliance or otherwise.

²⁵ See, eg, *Cadbury Report*, above n 2, [3.5]; International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation* (June 2010) 3; North, above n 22, 9–42. The stated rationales for company reporting regimes are typically a blend of market fairness, market efficiency, investor protection, and corporate governance.

²⁶ Institute of Directors (NZ), ‘Response to NZX Review of Corporate Governance Reporting Requirements’ (25 February 2016) 1, <<https://www.iod.org.nz/Portals/0/Governance%20resources/IoD%20submission%20to%20NZX%20Feb%202016.pdf>>. There is no accepted definition of ‘stakeholders’. For the purposes of this chapter, the term applies to groups or individuals that contribute to, or are influenced or impacted by, a company’s activities.

²⁷ Financial Reporting Council, above n 13, 4.

²⁸ *Ibid*; OECD, *Principles of Corporate Governance*, above n 8, 11.

Given the strictness of these principles, most listed companies have altered their board arrangements to comply with them, albeit that a minority of companies (usually smaller companies) prefer to explain their non-compliance. In contrast, the disclosure and engagement principles within the same governance codes are broad and open to interpretation. Indeed, some companies appear to interpret these principles as satisfied by the simple release of generic policy statements.

The publishing of corporate governance statements is a form of market transparency. Fung, Graham and Weil describe a transparency program as a continuous ‘action cycle’²⁹ that is initiated when new information is disclosed. Users must then comprehend this information and respond to the discloser or change their behaviour based on the information disclosed. Finally, the discloser must react appropriately to the user responses or changed behaviour. Importantly, the success of a transparency program requires fulfilment of each stage of the action cycle. Within the corporate governance context, the transparency program in operation is based on a series of assumptions. First, it is assumed that a company will provide a candid and comprehensive governance statement that indicates whether it has fully complied with each of the principles, and if not, why not. Second, it is assumed that these statements are read and understood by shareholders (and possibly others). Third, it is assumed that investors (and others) will actively respond by adjusting the company’s valuation or their investment or trading parameters, by changing their conduct, or by directly engaging with the company. Finally, it is assumed that the company will constructively respond to the outsiders’ engagement and or conduct and adjust its behaviour in relation to the issues raised. Each of these assumptions can be challenged. For example, some commentators argue that corporate governance statements do not impact investment decisions because investors do not assess these statements and do not engage with companies about their governance practices. Keay notes that ‘research suggests that investors do not monitor sufficiently and do not generally bother to engage in any assessment of what companies have done or not done’.³⁰ Keay’s argument is supported by empirical studies that find investor evaluations of governance statements are often nonchalant or muted, particularly while a company’s financial performance remains strong.³¹ These study findings raise important

²⁹ See Archon Fung, Mary Graham and David Weil, *Full Disclosure: The Perils & Promise of Transparency* (Cambridge University Press, 2007).

³⁰ Andrew Keay, ‘Comply or Explain: In Need of Greater Regulatory Oversight’ (2014) 34 *Legal Studies* 279, 293.

³¹ Ruth Aguilera and Alvaro Cuervo-Cazzura, ‘Codes of Good Governance’ (2009) 17 *Corporate Governance: An International Review* 376, 383. See also Iain MacNeil and Xiao Li, ‘“Comply or Explain”: Market Discipline and Non-Compliance with the Combined Code’ (2006) 14 *Corporate Governance International Review* 486; Christian Andres and Erik Theissen, ‘Setting

issues concerning the intended or desired responses from investors to specific items within corporate governance statements and the governance conduct of businesses more broadly, as well as the motivations driving these responses.

The author has been unable to locate any examples internationally of a company acknowledging partial or full non-compliance with any disclosure or engagement code principle or provision in its governance statement.³² Regardless, one needs to consider the likely response of investors to instances of non-compliance with a disclosure or engagement provision or to an inadequate explanation of the non-compliance. Investor responses to disclosure and engagement governance concerns would be likely to vary greatly depending on their capacity to gain private access to the relevant directors and senior managers. Investors and stakeholders with direct access to boards and executives can discuss matters in depth with the corporation and are therefore relatively less concerned by public disclosure and engagement deficiencies than other participants. Indeed, when acting on an economically rational basis, these participants might prefer public reporting of a lower standard to enable them to benefit commercially from the receipt of higher value private information.³³ It is the other shareholders (and stakeholders) without private access to corporate management that most require effective public disclosure and engagement structures, including reasonable opportunities for dialogue with company leadership, regular monitoring of the content and timing of company disclosures, and enforcement of the relevant law when appropriate.³⁴ It is also the interests and rights of these shareholders and stakeholders that remain most contentious, and this is reflected in corporate governance debates worldwide.

a Fox to Keep the Geese — Does the Comply-or-Explain Principle Work?’ (2008) 14 *Journal of Corporate Finance* 289.

³² Notably, this claim is limited to corporate governance code principles or provisions governing disclosure or engagement matters. The author would welcome any contrary examples.

³³ The larger the gaps between the quality of information provided privately and publicly, and the longer the timeframe between its release privately and publicly, the higher its potential commercial value.

³⁴ Stakeholder communities, such as employees and suppliers, may have considerable perceived or actual negotiation strength with a company, given their critical role in business operations. Other groups, such as communities impacted by environmental issues and breaches of human rights, may have to rely on public good arguments or moral persuasion.

IV DISCLOSURE AND ENGAGEMENT PROVISIONS IN THE UK CORPORATE GOVERNANCE CODE

A *Disclosure and Engagement Provisions in the UK Code*

The *Corporate Governance Code* in the UK applies to listed corporations and aims to encourage boards to be effective, accountable, transparent in their decision making and communications and focused on the long-term success of the company.³⁵ The UK Code is overseen by the UK Financial Reporting Council which has a stated mission to promote transparency and integrity in business.³⁶ Importantly, the heading of Section C of the UK Code is ‘accountability’. Principle C.1 states that ‘the board should present a fair, balanced and understandable assessment of the company’s position and prospects’.³⁷ Code provision C.1.1.1 confirms that annual reports are necessary ‘for shareholders to assess the company’s position and performance’, meaning that the intended audience of annual reports is limited to shareholders. The supporting principles within section C indicate that the board’s disclosure responsibilities extend to all public reports and information required under legislation, ensuring that the linkages between the Code principles relating to disclosure and the broader company disclosure framework are acknowledged.³⁸ The statutory obligations under the *Companies Act 2006* (UK) (*‘Companies Act’*) require most companies to provide half year and annual reports, and listed companies must also comply with continuous disclosure rules and the London Stock Exchange disclosure listing rules.³⁹

Code provision C.1.2 states that directors should explain the company’s business model (that is, how it generates or preserves value over the longer term) and the strategy for delivering its objectives. Inclusion of this provision within the UK Code is commendable, albeit that it reiterates the obligations in

³⁵ Financial Reporting Council, above n 13, 1.

³⁶ Ibid

³⁷ Ibid 16.

³⁸ These broader disclosure frameworks include principle and rule-based law. As Black notes, it is ‘hard to classify any one regulatory regime as being either entirely rules based or entirely principle based; the better question is what is, and should be, the relative roles of each: Julia Black, ‘The Rise, Fall and Fate of Principles-Based Regulation’ (London School of Economics Law, Society and Economy Working Papers 17/2010) 24 subsequently included in Kern Alexander and Niamh Moloney (eds), *Law Reform and Financial Markets* (Edward Elgar, 2011). See also Julia Black, ‘The Forms and Paradoxes of Principles Based Regulation’ (2009) 3 *Capital Markets Law Journal* 425.

³⁹ For a brief overview, see North, above n 22, 131–4.

Ch 4A of the *Companies Act*⁴⁰ that are discussed in Part VC of this article. Provision C.1.2 reflects the increasing market demands globally for companies to publicly explain their long-term strategies and performance.

Principle E.1 of the UK Code states that it is the board's responsibility to ensure that satisfactory dialogue with shareholders takes place.⁴¹ This principle repeats the traditional focus on board communication with shareholders. Code Provision E.1.1. indicates that the Chairman should discuss governance and strategy with major shareholders and that non-executive directors should be encouraged to attend these meetings.⁴² Encouragement of private dialogue between company boards and major shareholders is a consistent theme in corporate policy debates in the UK, as evidenced in Code Provision E.1.1 and the Kay Review of Equity Markets,⁴³ and, to a lesser extent, the UK *Stewardship Code*.⁴⁴ While private briefings are common in other jurisdictions, their use is encouraged more openly in the UK than in other countries.

B Disclosure and Engagement Provisions in Practice

Policy makers and scholars commonly assume that corporate governance and disclosure models which rely on private meetings with core investors lead to superior governance and corporate outcomes.⁴⁵ However, these assumptions are based on incomplete evidence and lack clear empirical support. Private meetings between corporate directors and institutional participants may be used to discuss important governance issues and these discussions may result in

⁴⁰ Amended by adoption of the *Companies Act 2006* (Strategic Report and Directors' Report) Regulations 2013.

⁴¹ Financial Reporting Council, above n 13, 22.

⁴² Ibid.

⁴³ See, eg, *The Kay Review of UK Equity Markets and Long-Term Decision Making: Interim Report* (February 2012); *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report* (July 2012) <http://www.ecgi.org/conferences/eu_actionplan2013/documents/kay_review_final_report.pdf>. See also Gill North, 'Listed Company Disclosure and Financial Market Transparency: Is This a Battle Worth Fighting or Merely Policy and Regulatory Mantra?' (2014) 6 *Journal of Business Law* 486. North argues that the Kay Review reports assume a privileged role for financial intermediaries, and in doing so, discount the role, rights and needs of direct investors.

⁴⁴ See, eg, Tomorrow's Company, *Better Stewardship: An Agenda for Concerted Action* (January 2018) <https://tomorrowcompany.com/wp-content/uploads/2018/01/Better-Stewardship-An-agenda-for-concerted-action_-25Jan2018.pdf>.

⁴⁵ See Eugene Soltes, 'Private Interaction Between Firm Management and Sell-side Analysts' (2014) 52 *Journal of Accounting Research* 245; Steve Johnson, above n 14. Policy makers and scholars often rely on exaggerated and unsubstantiated caricatures of institutional and non-institutional investors to substantiate these claims. But see Alastair Lawrence, 'Individual Investors and Financial Disclosure' (2013) 56 *Journal of Accounting and Economics* 130.

positive change. For instance, an institutional investor may demand or negotiate specific governance improvements at a corporation and patiently wait for the desired changes to be reflected in the security price. In any event, models that unduly emphasise the governance (or stewardship) role of institutional investors do not provide a balanced or holistic picture of the processes required to enhance corporate governance and accountability in financial markets. Institutional investors often seek direct access to corporate executives to obtain ongoing information, updates and signals from corporations, and are powerfully motivated to do so because informational or timing advantages in financial markets are valuable. This value is greatest when information is obtained by the institutional investor in advance of other participants, and this results in trading gains (or reduced losses) without the need for diligent and sophisticated analysis. All other things being equal, investors or traders who obtain superior or timelier information from companies than other participants will profit to the detriment of those who are less informed.⁴⁶

Concerns regarding corporate communication centred on private meetings remain largely unaddressed.⁴⁷ Instead, the operation and outcomes of these private forums remain shrouded in secrecy and the players' sense of entitlement. Corporate communication structures are inherently political and can have a profound impact on people's reputation, professional standing, and wealth. The way in which these frameworks operate determines or influences: the reputation and remuneration of company directors and executives; the returns and competitiveness of asset managers, brokers, and other financial market service providers; the interests of corporate advisers such as lawyers, accountants, auditors and consultants; the public face of companies; and outcomes for other shareholders and persons affected by corporate activity.⁴⁸

Demand from institutional investors for private contacts with company executives is intense and the battles for the best access to senior executives span the full spectrum of participants. The associated power games are typically won by those with perceived or actual wealth and political influence. Hence, the financial institutions that control the largest funds or trading portfolios hold most sway given their voting power and greater capacity to pay or manoeuvre for private access. The *Financial Times* in the UK reported in 2013 that asset

⁴⁶ United States Securities and Exchange Commission, *Proposed Rule: Selective Disclosure and Insider Trading* (2000).

⁴⁷ See Gill North, 'Closed and Private Company Briefings: Justifiable or Unfair?' (2008) 26 *Company and Securities Law Journal* 501.

⁴⁸ See, eg, Anil Gürtürk and Rüdiger Hahn, 'An Empirical Assessment of Assurance Statements in Sustainability Reports: Smoke Screens or Enlightening Information?' (2016) 136 *Journal of Cleaner Production* 30.

managers were paying large sums of money to brokers and investment bankers to arrange meetings with chief executive officers. An anonymous senior figure from a large UK asset manager confirmed that payments for corporate access were commonplace and that this was how things have always operated.⁴⁹ While asset managers and others may consider payments for executive access as ‘normal’,⁵⁰ such conduct does not create an environment that is likely to enhance corporate governance standards and performance. Analysis by the Financial Services Authority confirmed that some large asset managers were making payments for executive access using client commissions. While this practice is now banned in the UK,⁵¹ this ban relates only to payments for access to executives and does not prohibit private meetings per se.

The UK Code does not outline the scope or specificity of matters encompassed within the areas of governance and strategy that are appropriate for discussion at private meetings with core investors. Nor does the UK Code define the type of governance and strategic content that is considered materially price sensitive and therefore required to be disclosed publicly under the continuous disclosure regimes rather than in private forums. The lack of detail on these issues is problematic. Policy makers and others seem to assume that only core institutional participants are interested in, and require, detailed ongoing knowledge about a company’s strategy and corporate governance processes. Under the present disclosure rules, other investors and stakeholders are left to make decisions based on summaries provided in annual reports once a year, as discussed more fully in Part VC.

The differences in the scale and quality of the information sets provided by companies privately and publicly are substantial, although difficult to explain or demonstrate to people outside of the system. For readers who are teachers, an imperfect analogy may assist. Assume your company law class is split equally into two groups of students based on whether they have brown or blue eyes. The information you give the students with brown eyes is limited to two sets of summary information comprising two to four pages; one is provided half way through the unit and the other at the end of the unit (equivalent to the half year and full year reports).⁵² This group of students is not permitted to meet with you or ask questions during the unit duration but can read 4 or 5 short updates from the unit website during this period (equivalent to continuous

⁴⁹ Johnson, above n 14.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² The number of pages in company annual reports may be in the hundreds but the important commentary (or management discussion and analysis) within these reports is often limited to between two and four pages.

disclosures).⁵³ Your blue-eyed students receive the same summary commentary and short updates as the other group, but are also able to meet with you to discuss the unit content and ask questions (either in your office or by phone) once every two weeks for two hours. In addition, these students are permitted to provide you with draft assignment and exam papers and receive personalised feedback. Ask yourself whether you would expect similar unit results from these two cohorts and whether investors under these conditions can trade on an equitable basis.

C *Proposed Reforms to the Corporate Governance Code in the United Kingdom*

The UK Government has confirmed plans to reform the UK *Code* and has indicated that there was strong support for action to strengthen the stakeholder voice during the submission and consultation processes, and that many participants thought companies should do more to reflect their responsibilities to employees, customers and wider society.⁵⁴ The Government has accepted three reform proposals to address these concerns: 1) the enactment of legislation requiring all companies (public and private) of a significant size to explain how their directors comply with the requirements of section 172 of the *Companies Act*; 2) the introduction of a new UK Code principle ‘establishing the importance of strengthening the voice of employees and other non-shareholder interests at board level as an important component of running a sustainable business’ and; 3) the encouragement of industry initiatives and guidance regarding corporate engagement with employees and other stakeholders.⁵⁵ The nature and structure of section 172 are examined in Part VB.

The final UK Code reforms are still to be determined. Key issues that are still under consideration include the levels of discretion that companies will be given to determine the nature, form and scope of the explanations regarding

⁵³ While listed companies typically release more than four or five continuous disclosures during a year, in most cases only a minority of these releases contain substantive and financially material information.

⁵⁴ Department for Business, Energy and Industrial Strategy (BEIS), ‘Corporate Governance Reform: The Government Response to the Green Paper Consultation’ (August 2017) [2.3], Annex B <www.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf>. See also BEIS, *Corporate Governance Reform Green Paper* (November 2016) <www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf>.

⁵⁵ See ‘Corporate Governance Reform: The Government Response to the Green Paper Consultation’, above n 54, 4. There was no agreement from the initial respondents on the best reform options: at [2.5]–[2.24].

their compliance with section 172 and the degree and form of engagement with stakeholders who are not shareholders. The UK Government envisages that companies will be required to explain ‘how key stakeholders have been identified, how their views have been sought, why the company’s engagement mechanisms were considered appropriate, and how the information obtained from them influenced the board’s decision making.’⁵⁶ Companies could also be required to adopt specific stakeholder-related objectives, with key performance indicators and progress updates. More importantly, companies may be required to include a stakeholder representative on the board, or establish stakeholder advisory panels, or to provide a designated non-executive director to represent and give voice to key stakeholder groups.⁵⁷ Consultations are underway, and the general counsel of the leading UK companies have been asked to provide advice and guidance on the practical interpretation of the director duties under section 172.⁵⁸

V ARE THE CORPORATE DISCLOSURE AND ENGAGEMENT FRAMEWORKS IN THE UK ACHIEVING THEIR OBJECTIVES?

A Overview

The proposed reforms in the UK rely heavily on disclosure mechanisms, including a strategic report that must be published by most companies within the annual report and publicly released no later than four months after a company’s financial year end.⁵⁹ Section 414C(1) states that the ‘purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company)’. As the purpose of the strategic reports is to allow *shareholders* to assess the extent and manner of a company’s compliance with section 172, it is important to explore the nature and structure of this director duty before considering the disclosure requirements.

⁵⁶ See, eg, Shearman, Shearman and Sterling, *UK Corporate Governance Reform — The Government’s Final Proposals* (1 September 2017) Perspectives <<https://www.shearman.com/perspectives/2017/09/uk-corporate-governance-reform>>.

⁵⁷ ‘Corporate Governance Reform: The Government Response to the Green Paper Consultation’ above n 54, 4–5.

⁵⁸ *Ibid* 4.

⁵⁹ *Companies Act 2006* (UK) s 414A.

B The Section 172 Duty

Section 172 of the *Companies Act* came into force on 1 October 2007 and provides that:

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

The primary duty of directors under this section is therefore to promote the success of the company for the benefit of its shareholders as a whole, and the factors listed within section 172(1)(a)-(f) need only be considered in light of this overarching duty.⁶⁰ The structure of section 172 raises important issues that impact on the scope and credibility of the proposed reforms.

First, what does acting in the interests of the shareholders as a whole mean? Lord Goldsmith indicated in the UK Parliament that the section 172 duty

is to promote the success for the benefit of the members as a whole — that is, for the members as a collective body — not only to benefit the majority shareholders, or any particular shareholder or section of shareholders, still less the interests of directors who might happen to be shareholders themselves.⁶¹

⁶⁰ Andrew Keay, 'Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's "Enlightened Shareholder Value Approach"' (2007) 29 *Sydney Law Review* 577, 592, 597.

⁶¹ *Lords Grand Committee*, 6 February 2006, column GC256.

This statement makes clear that companies should not act solely in the interests of majority shareholders but does not explain how the board should balance the interests of majority and minority shareholders when these interests diverge.⁶² All shareholders in a company benefit when a company's overall valuation increases, and this is reflected in the share price. However, when shareholders buy or sell a company's securities, the required balancing is more complex. If one assumes that the primary goal of investors is to maximise their financial returns, one shareholder or class of shareholders can do this at the expense of others. As discussed, demands from institutional investors for private briefings with corporate leaders are intense because these participants hope these briefings will give them an informational advantage vis-à-vis other market participants. Secondary trading of existing company securities is a zero-sum game and when one side of a trade gains on a trade, the counterparty loses to the same extent. Thus, assuming all other factors are equal, the private corporate communication structures operate in favour of the participants who have been given the best access and information, to the detriment of other shareholders. 'Fairness between shareholders' is one of the specified factors that directors must have regard to under section 172. When considering fairness issues across the shareholder base, though, the primary duty of directors is to promote the success of the company for the benefit of its shareholders as a whole. To show compliance with this duty, directors could legitimately argue that the private communication structures are in the interests of 'shareholders as a whole', even when they allow shareholders with superior access to company managers and information to profit at the expense of those with poorer quality information and less regular or no direct access to managers.

The UK regulatory structure includes regimes that encourage continuous disclosure and penalise insider trading and that are intended to mitigate the potential shifts in wealth that flow to traders with 'inside' information.⁶³ In order to comply with these regimes, companies with well-established private communication structures typically argue that the information conveyed

⁶² See Keay, above n 60, 601.

⁶³ A company listed in the UK is subject to the continuing obligations imposed by the Financial Conduct Authority (FCA) and the London Stock Exchange. The key continuing obligations imposed by the FCA can be found in the Listing Rules and the Disclosure Guidance and Transparency Rules (DTRs). See, especially, Financial Conduct Authority Handbook, DTR 2.2.1, DTR 2.5.1. Article 8 of the Market Abuse Regulation (Regulation 596/2014) prohibits insider trading 'where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates'. Under the *Criminal Justice Act 1993* (UK), it is a criminal offence to deal in securities on the basis of inside information, which is information that is not yet publicly known and which would affect the price of the securities if it were made public.

privately is not materially price sensitive and merely provides an expanded explanation of the publicly disclosed content. The validity of these arguments is difficult to assess since most of the detailed communication between corporations and the market occurs behind closed doors and since these exchanges are not independently monitored and enforced.

Based on her global experience as a financial analyst, the author suggests that the true costs of private corporate communication structures to corporations, shareholders, other stakeholders, and the broader community are difficult to overstate. These costs include the time of the senior executives attending and involved in these briefings, ongoing redistributions of trading wealth to the largest investment entities, and the more holistic and significant costs that arise when the governance and public communication structures of individual corporations are poor. When large corporate collapses and/or significant market or financial crises occur, major communication failures and/or conflicts of interest are generally revealed. In the wake of these catastrophic events, policy makers and others often highlight the consequences and costs of poor governance and corporate and financial market opacity. For instance, both the UK's Treasury Select Committee and the OECD Steering Group on Corporate Governance formed the view that weak corporate governance was a major cause of the financial crisis post 2009.⁶⁴ However, the full cost of corporate and financial market opacity extends well beyond the consequences of these major events. As the OECD notes, poor and inadequate corporate disclosure commonly reflects unethical behaviour and a lack of business integrity.⁶⁵ Similarly, as Jay Clayton, the Chairman of the Securities and Exchange Commission in the United States observed recently, '[l]ooking back at enforcement actions, a common theme emerges — where opacity exists, bad behaviour tends to follow'.⁶⁶ Put simply, corporate and financial environments that are permitted to operate in the shadows without robust governance and

⁶⁴ House of Commons Treasury Committee, 'Banking Crisis: Reforming Corporate Governance and Pay in the City' (London, Stationery Office, 2009) and quoted in M Arden, 'Regulating the Conduct of Directors' (2010) 10 *Journal of Corporate Law Studies* 1, 1.

⁶⁵ These private communication structures are further undermined by policy settings that allow institutional investors to own, operate and use dark trading venues that operate in the shadows of major securities exchanges. See Michael Lewis, *Flashboys: A Wall Street Revolt* (W W Norton, 2015). See also Gill North and Ross Buckley, 'A Financial Transaction Tax: Inefficient or Needed Systemic Reform?' (2012) 43 *Georgetown Journal of International Law* 745.

⁶⁶ Jay Clayton, Securities and Exchange Commission Chairman, 'Governance and Transparency at the Commission and in Our Markets' (Remarks at the Practising Law Institute 49th Annual Institute on Securities Regulation, New York, 8 November 2017).

disclosure structures tend to become toxic and rarely lead to optimal corporate or national outcomes.

When corporate leadership or institutional investors behave badly, or the performance of corporations is suboptimal because of poor governance, a large share of the resulting costs is typically borne by stakeholders and the broader community. This pattern raises a second major issue with section 172, namely how should company boards in the UK approach situations where the interests of shareholders conflict with the interests of other stakeholders?⁶⁷ In many circumstances, the interests of stakeholders will be aligned with the interests of shareholders and the corporation as an entity (especially over the long term), while at other times these interests will diverge. In its current form, section 172 explicitly encourages boards to ignore or trade off the factors in section 172(1)(a)-(f) either partially or fully, when this is necessary to maximise shareholder benefits, even if this results in detrimental impacts on other stakeholders or the environment.⁶⁸ Importantly, the Company Law Review Steering Group that recommended the introduction of section 172 considered policy options that would have required directors to consider the interests of stakeholders alongside the benefits to shareholders, but specifically rejected these avenues.⁶⁹

A third major structural issue that has received scarce attention in scholarly literature concerns the timeframe of business decision making under section 172. Many policy makers and scholars highlight concerns relating to the short-term focus of many businesses and an undue preoccupation by listed corporations with their short-term share price.⁷⁰ These concerns are highlighted in the UK Code and corporate governance reform documents.⁷¹ Yet ‘long term consequences’ are listed as a secondary factor in section 172, so directors are potentially encouraged to prioritise short term returns to shareholders, even

⁶⁷ See also Keay, above n 60, 599.

⁶⁸ The equivalent director duties in other jurisdictions, such as s 181 of the *Corporations Act 2001* (Cth) in Australia, do not explicitly list the interests of other stakeholders and impacts on the environment as secondary factors. Nonetheless, many scholars and others argue that most, if not all, corporate boards primarily focus on shareholder returns when making business decisions, even when this requires compromises in relation to other factors, such as those listed in s 172.

⁶⁹ See Company Law Review Steering Group, Department of Trade and Industry, *Modern Company Law for A Competitive Environment: The Strategic Framework* (1999) 37–8. See also Keay, above n 60, 592.

⁷⁰ See, eg, Andrew Keay, ‘Ascertaining the Corporate Objective: An Entity Maximisation and Sustainability Model’ (2008) 71 *Modern Law Review* 663.

⁷¹ See, eg, Financial Reporting Council, above n 13, s C.1.2.

when this is not in the long-term interests of the corporation and is not economically, environmentally and socially sustainable.

Section 172 is often referred to as embodying an ‘enlightened shareholder value’ approach, but the extent to which the duty to preference shareholders is in fact ‘enlightened’ remains highly contentious.⁷² For example, a report on the social responsibility of corporations by the Corporations and Markets Advisory Committee in Australia concluded that

A non-exhaustive catalogue of interests to be taken into account serves little useful purpose for directors and affords them no guidance on how various interests are to be weighed, prioritised and reconciled ... The Committee considers that ... to require or permit directors to have regard to certain matters or the interests of certain classes of stakeholders, could in fact be counterproductive. There is a real danger that such a provision would blur rather than clarify the purpose that directors are to serve. In so doing, it could make directors less accountable to shareholders without significantly enhancing the rights of other parties.⁷³

The two-tiered structure of section 172 is deeply misguided and sends the wrong message to corporate boards (and outsiders) in the current environment. The duty does not assist boards to make carefully calibrated business decisions with a long-term view. Instead, it arguably encourages directors to prioritise short term returns to investors even when this involves deeply compromised outcomes for other stakeholders and the environment. As the proposed reforms do not seek to change the structure of section 172, they may ultimately raise more questions than provide solutions.

C *The Strategic Reporting Obligations*

Company disclosure regimes are typically structured hierarchically, with minimal requirements for the smallest private companies and the most onerous

⁷² For further discussion on s 172, see, eg, Andrew Keay, ‘Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective’ [2006] *Lloyd’s Maritime and Commercial Law Quarterly* 335; Peter Hood, ‘Directors’ Duties Under the Companies Act 2006: Clarity or Confusion?’ (2013) 13 *Journal of Corporate Law Studies* 1. For broader discussion, see Andrew Keay and Hao Zhang, ‘An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law’ (2011) 8 *European Company and Financial Law Review* 445; Andrew Keay, ‘The Duty to Promote the Success of the Company: Is It fit For Purpose?’ (2011) 32 *Company Lawyer* 1; Charlotte Villiers, ‘Sustainable Companies: Barriers and Possibilities in UK Company Law’ (2015) 11 *International and Comparative Corporate Law Journal* 105.

⁷³ See, eg, Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations Report* (December 2006) 111–2.

obligations placed on listed companies. This pattern is adopted in Chapter 4A of the *Companies Act*. All companies in the UK other than those categorised as ‘small’ must provide a strategic report including a review of the company’s business and a description of the principal risks and uncertainties facing the company.⁷⁴ Further analysis using key performance indicators may also be necessary.⁷⁵ Listed companies are required to do more and must explain the factors that will affect the company prospectively and the company’s business model.⁷⁶

The Financial Reporting Council has published a detailed guide to assist companies with preparation of the strategic report.⁷⁷ Nonetheless, there are no details in the *Companies Act* or elsewhere that discuss how companies should link the content provided in their strategic report to their compliance with section 172 and how they ought to explain the practical implications of the section 172 duty, including specific outcomes. While companies are required to provide explanatory disclosures on the secondary factors listed in section 172(1)(a)–(f), the stated audience is limited to shareholders and the content and usefulness of these reports are challengeable. The open nature of section 172 allows companies to interpret the requirement to have regard to the secondary matters either very narrowly or generously. In worst case scenarios, the commentary provided in the strategy reports may be procedural, highly generic, or at such a high level that its probative value is minimal.

⁷⁴ *Companies Act 2006* (UK) s 414C(2)–(3). Failure to provide the strategy report constitutes a criminal offence: s 414A(5)–(6). In 2014, the European Union enacted legislation requiring the provision of non-financial information: Art 6 Directive 2014/95/EU. For discussion on these reforms, see Gill North, ‘Company Reporting of Environmental, Social and Gender Matters: Limitations, Barriers and Changing Paradigms’ in Beate Sjøfjell and Irene Lynch Fannon (eds), *Creating Corporate Sustainability: Gender as an Agent for Change* (Cambridge University Press, 2018) 91.

⁷⁵ *Companies Act 2006* (UK) s 414C (4)–(5). Where a company qualifies as medium-sized in relation to a financial year (see sections 465 to 467), the review for the year need not comply with the requirements of subsection (4) so far as they relate to non-financial information: s 414C(6).

⁷⁶ *Companies Act 2006* (UK) s 414C (7). Subsection 7 provides that in the case of a quoted company the strategic report must, to the extent necessary for an understanding of the development, performance or position of the company’s business, include—(a) the main trends and factors likely to affect the future development, performance and position of the company’s business, and (b) information about—(i) environmental matters (including the impact of the company’s business on the environment), (ii) the company’s employees, and (iii) social, community and human rights issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies.

⁷⁷ Financial Reporting Council, *Guidance on the Strategic Report* (June 2014).

D *Are the Disclosure and Engagement Governance Rules Effective?*

In financial markets without company disclosure regulation, boards would have the discretion to determine whether to disclose specific information to the market, whether to disclose information privately or publicly, the specific investors to whom information is disclosed, and when to disclose information. In voluntary disclosure settings, many listed company managers would likely provide public disclosures only when required for procedural purposes, or for operational or reputational reasons, such as the raising of new capital or to encourage higher security prices. Disclosure regulation that encourages or requires companies to publicly disclose material information is intended to result in more equitable and broader access to corporate information, more efficient markets, and more balanced reporting that encompasses disclosure of both positive and negative news.⁷⁸ However, these regimes are effective only when they alter the private versus public disclosure incentive equations and when the perceived and actual levels of market and regulatory deterrence are sufficient to change behaviour.

Under UK company law, corporate directors and managers can achieve similar outcomes to those that would naturally be achieved in markets without disclosure rules (at least over shorter periods) by restricting most of their communication (beyond release of the periodic financial statements) to private discussions with a core group of selected institutional investors. Company directors and senior executives continue to be strongly motivated to disclose the most detailed company information required for security valuation and corporate procedural purposes to only a limited number of selected investors, especially when the relevant information may adversely impact the value of the corporation or the directors' personal standing or remuneration, or when the company is performing badly. Providing information in this manner allows companies to avoid public scrutiny, and to thereby limit their potential exposure to, and accountability for, poor business judgments and suboptimal performance. These processes also allow boards and executives to restrict the opportunities for dialogue afforded to other participants to low level forums, such as investor relations websites, surveys, and focus groups.⁷⁹

Regular private exchanges and close relationships between corporate boards and invited investors are prone to promote cronyism, executive access based on favours, uncritical acceptance of the company's agenda, and a lack of probity

⁷⁸ International Organization of Securities Commissions, *Objectives and Principles of Securities Regulation* (June 2010) 3.

⁷⁹ North, above n 22, 207–10.

and accountability.⁸⁰ Documented examples of these proclivities and practices abound. Empirical work confirms that most analysts and institutional investors are concerned with the need to stay in favour with companies to maintain private access to executives. Those who criticise or raise the alarm about managerial misconduct are commonly frozen out from company communication channels, particularly when companies are facing adverse conditions or financial pressures.⁸¹ Other bodies of empirical research that examine company reporting standards (including traditional financial reporting and corporate sustainability reporting) highlight issues with the overall quality of company reports released publicly.⁸² In particular, many studies find that companies delay, disguise or entirely fail to disclose ‘bad news’, even in jurisdictions with reporting regimes.⁸³ Given this compelling evidence, recommendations that promote dialogue on governance matters predominantly at private meetings with core investors are open to serious challenge. Policy makers and regulators need to explain why they continue to permit, and even encourage, corporations to communicate primarily at closed meetings with selected investors.⁸⁴

⁸⁰ See, eg, Jill Fisch and Hillary Sale, ‘The Securities Analyst as Agent: Rethinking the Regulation of Analysts’ (2003) 88 *Iowa Law Review* 1035; Donald C Langevoort, ‘Investment Analysts and the Law of Insider Trading’ (1990) 76 *Virginia Law Review* 1023, 1042.

⁸¹ Fisch and Sale, above n 80, 1056; Bin Ke and Yong Yu, ‘The Effect of Issuing Biased Earnings Forecasts on Analysts’ Access to Management and Survival’ (2006) 44 *Journal of Accounting Research* 965. For example, John Olsen, the Merrill Lynch energy sector analyst, was fired when he downgraded Enron’s stock. Similarly, analysts who criticised HIH Insurance prior to its collapse were blacklisted.

⁸² For a summary outline, see North, above n 22, 207–10. See also John Peloza, ‘Using Corporate Social Responsibility as Insurance for Financial Performance’ (2006) 48 *California Management Review* 52; David Hess, ‘The Three Pillars of Corporate Social Reporting as New Governance Regulation: Disclosure, Dialogue and Development’ (2008) 18 *Business Ethics Quarterly* 447, 462–3; Itziar Castello and Josep M Lozano, ‘Searching for New Forms of Legitimacy through Corporate Responsibility Rhetoric’ (2011) 100 *Journal of Business Ethics* 11; Breeda Comyns et al, ‘Sustainability Reporting: The Role of “Search”, “Experience” and “Credence” Information’ (2013) 37 *Accounting Forum* 231, 232–4, 241.

⁸³ For outlines of the scholarly empirical studies that confirm positive biases within financial reporting, see North, above n 22, 189–97. For references to empirical studies that find optimistic biases in corporate sustainability reporting, see Gill North, ‘Corporate Sustainability Practices and Regulation: Existing Frameworks and Best Practice Proposals’ in Jean du Plessis and Chee Keong Low (eds), *Corporate Governance Codes for the 21st Century: International Perspectives and Critical Analyses* (Springer Publishing, 2017) 145.

⁸⁴ Langevoort, above n 80, 1028, 1054. See also Paul Davies et al, ‘European Company Law Experts’ Response to the European Commission’s Green Paper “The EU Corporate Governance Framework”’ (22 July 2011) 1 <http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework/individual-replies/ecle_en.pdf>.

Effective corporate governance structures require careful checks and balances to prevent excessive and inappropriate business conduct from occurring, or to mitigate it. Important elements of these structures include capacity for independent scrutiny of decision making and mechanisms to hold corporations and their boards to account. Independent scrutiny of corporate boards encourages positive change in the behaviour of decisionmakers, and accountability mechanisms are necessary to enable the consequences of poor decisions to be brought to bear on the company.⁸⁵ The need for public transparency, probity and accountability is especially critical when the relevant companies are large, and there are major asymmetries of power, information, and resources between the board and outsiders, and between the various classes of investors and stakeholders. When company boards and senior executives are directing disclosure and engagement processes and have undue control and discretion, the voices and responses of actors with the least market power, such as casual workers or persons who are negatively impacted by corporate activity in developing countries, are often ignored or drowned out.⁸⁶ All investors and other persons significantly impacted and influenced by corporate activities need to be able to scrutinise and criticise companies, write independent research and commentary, and make well informed decisions without fear of losing access to high quality company information and meaningful engagement mechanisms.

E Negligible Market and Legal Consequences Associated with Corporate Communication Structures

Extensive interdisciplinary empirical studies suggest that well-structured company reporting regimes contribute significantly to improved governance, corporate, market and economic outcomes, and that these benefits are greater when the disclosure obligations are vigorously enforced. In summary, country-specific and global empirical studies consistently find significant associations between superior corporate and national outcomes and one or more of the following variables: high disclosure standards, vigorous enforcement of securities laws, broad investor participation, protection of minority shareholder rights, and enhanced public trust.⁸⁷

Other broader studies find a positive relationship between long term corporate sustainability performance and superior commercial outcomes, with minimal

⁸⁵ Andrew Keay and Joan Loughrey, 'The Framework for Board Accountability in Corporate Governance' (2015) 35 *Legal Studies* 252, 266–7.

⁸⁶ Hess, above n 82, 463–4.

⁸⁷ For summaries and analysis of these studies, see North, above n 22, 32–9; North, above n 83.

evidence to the contrary.⁸⁸ One study links superior corporate social responsibility performance to superior stakeholder engagement and suggests that ‘stakeholder engagement based on mutual trust and cooperation reduces potential agency costs by pushing managers to adopt a long-term rather than a short-term orientation’.⁸⁹ More broadly, empirical evidence suggests that corporate sustainability reporting regimes can result in real change to a company’s conduct and culture. Ioannou and Serafeim examined the effects of mandatory corporate sustainability reporting in 58 countries and found that the adoption of such reporting led to heightened managerial awareness of sustainability issues and additional company programmes focused on sustainable development and employee training. In these companies, corporate governance standards and ethical practices improved, the levels of bribery and corruption decreased, and managerial credibility was enhanced. All these positive benefits were more significant in countries with stronger law enforcement and independent assurance of the reports.⁹⁰

It is unsurprising that positive benefits identified in reporting studies are more significant in countries with stronger regulatory intervention and enforcement. Reporting rules need to be well monitored and enforced to demonstrate the likely consequences when companies fail to comply with the law and to continually emphasise the importance of public transparency and high-quality reporting. Yet most of the corporate law reforms that seek to enhance transparency via disclosure, to increase the accountability of corporate boards, and to provide a greater voice to affected persons, are occurring through changes to governance codes and cannot be legally enforced.⁹¹ Even when one shifts the focus to disclosure rules within the relevant exchange listing rules and

⁸⁸ See, eg, Robert Eccles, Ioannis Ioannou and George Serafeim, ‘Market Interest in Nonfinancial Information’ (2011) 23 *Journal of Applied Corporate Finance* 113; Philipp Kruger, ‘Corporate Goodness and Shareholder Wealth’ (2015) 115 *Journal of Financial Economics* 304; Yan Qiu, Amama Shaukat and Rajesh Tharyan, ‘Environmental; and Social Disclosures: Link with Corporate Financial Performance’ (2016) 48 *British Accounting Review* 102; Marlene Plumlee et al, ‘Voluntary Environmental Disclosure Quality and Firm Value: Further Evidence’ (2015) 34 *Journal of Accounting and Public Policy* 336.

⁸⁹ Beiting Cheng, Ioannis Ioannou and George Serafeim, ‘Corporate Social Responsibility and Access to Finance’ (2014) 35 *Strategic Management Journal* 1, 16.

⁹⁰ Ioannis Ioannou and George Serafeim, ‘The Consequences of Mandatory Corporate Sustainability Reporting’ (Working Paper 11-100, Harvard Business School, 20 August 2014). See also Robert Eccles, Ioannis Ioannou and George Serafeim, ‘The Impact of Corporate Sustainability on Organizational Processes and Performance’ (2014) 60 *Management Science* 2835.

⁹¹ Donald C Langevoort, ‘Cultures of Compliance’ (2017) 54 *American Criminal Law Review* 933.

corporate statute, instances of enforcement of these rules outside of the United States are scarce.⁹²

In the UK, the Financial Conduct Authority has fined listed companies for breaching the Disclosure and Transparency Rules that apply to listed companies. For example, Rio Tinto was fined approximately £27 million for failing to carry out an asset impairment test and recognise an impairment loss on the value of its mining assets in Mozambique.⁹³ Nevertheless, the level and scope of public enforcement actions governing company disclosure and engagement matters in the UK are minimal. The author has been unable to find an example of enforcement of the rules dealing with the provision of commentary in company reports in the UK. Similarly, no evidence could be found of monitoring of the information exchanged during private briefings or enforcement of the ban on payments for direct access to executives by the Financial Conduct Authority. This lack of monitoring and enforcement of company disclosure law weakens the credibility and efficacy of these regimes.

There are some positive corporate reporting and conduct trends and indicators, such as an increasing number of corporate signatories of the United Nations Compact Principles⁹⁴ and expanded corporate reporting on sustainability matters. Growing numbers of private and public actors (including corporate leaders) are challenging orthodox corporate governance principles and standards, driven by a conflation of factors, including the emergence of corporate sustainability goals, responsible investment principles,⁹⁵ and record

⁹² For more detailed discussion regarding enforcement of periodic reporting law, see North, above n 23.

⁹³ Financial Conduct Authority, 'Rio Tinto Fined 27 Million Pounds for Breaching Disclosure and Transparency Rules' (Media Release, 17 October 2017).

⁹⁴ See UNGC, above n 16.

⁹⁵ See Principles for Responsible Investment (PRI), 'About the PRI' <<https://www.unpri.org/about>>. The PRI states that it 'works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions'. It notes that it 'acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.' It is supported by, but is not part of, the United Nations. The PRI has 1700 signatories from over 50 countries representing USD 62 trillion. Signatories of PRI agree to: incorporate ESG issues into investment analysis and decision-making processes; be active owners and incorporate ESG issues into ownership policies and practices; seek appropriate disclosure on ESG issues by the entities in which they invest; promote acceptance and implementation of the Principles within the investment industry; work together to enhance their effectiveness in implementing the Principles; and report on their activities and progress towards implementing the Principles.

low levels of community trust in corporations.⁹⁶ While these factors are prompting significant changes in corporate conduct and reporting standards, many investors and other stakeholders continue to question the overall quality of corporate disclosure and engagement structures and outcomes, and are demanding more fundamental changes.⁹⁷

The corporate sector in the UK is aware of the need for real change. Nearly a decade ago, the Institute of Directors indicated that:

The role of business today is far more pervasive than ever before. ... The simplistic view that prevailed in the 1990s that business leaders need to focus exclusively on shareholder value as determined by the share price and that financial analysts are the best judge of business strategy simply cannot hold ground today. In a millennium survey 60% of those interviewed said they would punish companies that were not environmentally or socially responsible. This shows how social good has become a powerful competitive differentiator. Business run on true principles of transparency, equity, accountability, integrity and responsibility can make a difference that could give enormous pride to executives and provide the true incentive for driving the corporations.⁹⁸

This statement by the Institute of Directors neatly encapsulates many of the concerns that underpin the corporate governance reform agenda in the UK and elsewhere. The extent to which these concerns have been accepted within, and inculcated into, corporate culture, law, and outcomes a decade later remains open to question though. The recent governance reform debate and proposals in the UK suggest that the journey towards more responsible and inclusive corporations has a long way to run.

⁹⁶ See, eg, *Tomorrow's Company*, above n 44, 2.

⁹⁷ For further discussion, see North, 'Corporate Management and Communication of Environmental and Social Risks in Australia', above n 8; Gill North, 'Collaborative Activism around Climate Change: A New Regulatory Model in the Wings?' (Working Paper, Deakin Law School, April 2018).

⁹⁸ Institute of Directors, 'The Changing Role of Business in Society' (2009) quoted in Charlotte Villiers, 'Sustainable Companies: Barriers and Possibilities in UK Company Law' (University of Oslo Faculty of Law Legal Studies Research Paper Series No 2010-03) 19 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2280350>. See also *Australian Competition and Consumer Commission v Australia and New Zealand Banking Group Ltd* (2016) 118 *Australian Corporations and Securities Reports* 124, 151 [123] (Wigney J). Justice Wigney notes that there 'is a legitimate community expectation that Australian financial institutions will develop and maintain a good corporate culture which ensures that their staff do not engage in illegal, unethical and unprofessional conduct and do not act in disregard of the interests of their customers. The Australian public is entitled to expect that Australia's major corporations act as exemplary corporate citizens wherever in the world they may operate'.

It is appropriate for policy makers to seek to strengthen the voice of stakeholders, but this ‘voice’ will only be meaningful if company boards engage in constructive dialogue and respond to the issues raised. Stakeholders currently have negligible rights and remedies under corporate law when companies fail to provide them with relevant information or refuse to engage in dialogue. These stakeholders must generally rely on the goodwill of corporates, or form coalitions with shareholders to utilise the legal mechanisms available to shareholders, such as shareholder-led resolutions or director re-election processes.⁹⁹

VI CONCLUSION

The *Cadbury Report* and OECD corporate governance principles place great emphasis on corporate disclosure and engagement as mechanisms to enhance governance, promote high levels of corporate transparency, probity and accountability, and to sustain public trust and confidence in corporations. Empirical evidence confirms that well-designed corporate disclosure frameworks can alter managerial incentives, power imbalances and informational asymmetries. Mandatory reporting structures can oblige a company to consider business activities and impacts that have not been considered previously and may motivate the directors and managers to better strategise and to act in ways that create improved long-term performance and a more sustainable business. The reporting processes assist by providing the information to company leadership that is necessary for it to track its progress towards specific performance goals.¹⁰⁰ The reporting frameworks can also promote long term national interests and engender public trust by requiring high quality public disclosures and the establishment of forums and facilities that allow ongoing dialogue with a broad audience. Corporate disclosure regimes can be powerful tools to open companies to public scrutiny and to promote good conduct. When operating effectively, reporting structures enhance competitive drivers and establish a virtuous circle that consistently raises the standards of corporate governance and communication.

It is much easier to espouse the importance of corporate openness, integrity and accountability than to consistently achieve these outcomes. As Brandies highlighted more than a century ago, large corporations and financial institutions often benefit commercially from opaque and poorly supervised

⁹⁹ See North, ‘Corporate Management and Communication of Environmental and Social Risks in Australia’, above n 8. See also North, above n 97.

¹⁰⁰ Irene M Herremans and Sandy Herschovis, ‘Sustainability Reporting: Creating and Internal Self-Driving Mechanism’ (2006) 15(3) *Environmental Quality Management* 19.

environments.¹⁰¹ The political nature of company disclosure regulation often leads to heavily compromised regulatory settings, and these tendencies are reflected in UK law. First, the efficacy of the integrated regulatory framework governing listed company communication is severely weakened by the extensive use of private communication structures. Provision E.1.1 encourages listed companies to discuss governance and strategic matters privately with core investors and this encouragement is consistent with a predominant focus on this form of corporate communication in the UK. From the perspective of company boards, their legal advisers, and those given private access to company leadership, the use of tiered corporate communication structures is rational and reasonable. Instances of non-compliance with the disclosure and engagement provisions within the UK Code are unlikely to be challenged by institutional shareholders with direct access to the board and executives, when these participants are concerned about the need to maintain this channel of information.

Second, the incentives underpinning private communication structures are often poorly aligned with the broad objectives of governance and disclosure regimes. The existing legal frameworks generally serve the interests of corporate leaders and the largest institutional investors, and other shareholders and stakeholders are left with minimal market-based levers and legal rights and remedies. The periodic reporting regimes in the UK that require the provision of commentary within reports are open-ended and loosely framed, giving companies considerable scope to determine the regularity, form and specific content of information released publicly. Under the existing rules, listed companies can provide positively framed, highly generic, and short term focused commentary in the directors and strategic reports. When the most pertinent information and useful performance indicators are not provided, the capacity of minority shareholders and other stakeholders to obtain relevant and useful company information and engage in dialogue is either limited or non-existent. And when the content of publicly available corporate reports and disclosures is merely an indistinct shadow of the information provided privately, the disclosure regimes can provide a convenient regulatory façade to legitimise the extensive private communication networks.

Third, the corporate governance and disclosure structures are undermined by largely ineffective regulatory monitoring and enforcement. The UK Code operates largely within market parameters and cannot be legally enforced. In addition, the statutory and listing rule disclosure obligations are rarely enforced

¹⁰¹ See Louis Brandeis, *Other People's Money and How the Bankers Use It* (National Home Library Foundation, 1914) Ch V. See also Fung, Graham and Weil, 'Full Disclosure: The Perils and Promise of Transparency', above n 29, [125]–[126].

by the Financial Conduct Authority, and when they are, these actions concern the rules governing the financial statements and notes. No formal actions appear to have been initiated by either the UK Financial Reporting Council or the Financial Conduct Authority concerning reported commentary.

The extent to which the proposed governance reforms to the UK Code will strengthen the rights and remedies of stakeholders remains unclear given the hierarchical structure of section 172. The section 172 duty prioritises the interests of shareholders as a whole, and other factors are merely secondary considerations, including the fair treatment of shareholders, the likely long-term consequences of decisions, the interests of the employees, and the impact of the company's operations on the community and environment. The present structure of section 172 will limit the potential benefits of the reforms that seek to strengthen the voice of other stakeholders and improve disclosure on environmental and social matters.

To its credit, the Institute of Directors in the UK recognises that businesses should be driven by the principles of transparency, equity, accountability, integrity and responsibility. This organisation also acknowledges that it is no longer appropriate for companies to focus exclusively on shareholder value because companies are increasingly assessed by the community for their environmental and social responsibilities. The aims of the proposed reforms to the UK Code reflect these aspirations, but the devil will be in the detail and the key question is whether the final reforms will have real teeth and impact. The article encourages policy makers and others engaged in the corporate governance reform processes in the UK to respond seriously to the mounting demands for companies to do more to reflect their responsibilities to employees, customers and society, and to give stakeholders a greater voice in corporate boardrooms and beyond. The law governing listed company communication requires substantive reform, including a refocus on public communication structures to ensure that corporations are transparent, accountable, probative, inclusive and sustainable over the long term. Otherwise, there is a significant risk that the final reforms will constitute mere tinkering and will suffer from the same deficiencies as the existing corporate communication processes and rules; namely open-ended obligations that are unlikely to result in any significant market or legal responses or consequences, even when the quality of the public disclosure and engagement processes of companies is tokenistic.

POSTSCRIPT

A revised version of the *Corporate Governance Code* in the UK was introduced in July 2018.¹⁰² The revisions that have been made to the Code are significant and include important structural, cultural and directional shifts. Commentary on reporting has been relocated from the main sections of the Code into the introduction. The principles on relations with shareholders are then merged within an overarching first principle (Principle A) entitled ‘Board Leadership and Company Purpose’. Provision one of this initial principle recommends that the board should assess the basis on which the company generates and preserves value over the long term and explain this in the annual report.¹⁰³ More specifically, boards are asked to report on the consideration and management of opportunities and risks, the sustainability of the company’s business model, and the strategic contribution of its governance.¹⁰⁴ This provision is well framed and closely aligns with emerging global corporate developments and thinking.

Provision two of the Principle A recommends that boards should assess and monitor the culture of the company and report on relevant activities and actions. This reporting includes an explanation of the company’s dealings with its workforce.¹⁰⁵ Although discussion on the culture of a company within regulatory spheres is highly contested, corporate reporting on employee related matters in annual reports is already the norm in developed countries, especially by larger companies.

Provision three of Principle A retains the recommendation that the chair should seek regular engagement with major shareholders.¹⁰⁶ Provision five of Principle A encompasses the proposed reforms regarding communication with other key stakeholders.¹⁰⁷ Boards are asked to describe in the annual report how the interests of these stakeholders, and the other matters included in section 172, have been considered in discussions and decision making. Importantly, the predominant focus of this provision is the workforce. Boards are given three methods that can be used to engage with employees: 1) a director appointed from the workforce; 2) a formal workforce advisory panel; and 3) a designated non-executive director. Boards may use one or more of these three methods or

¹⁰² Financial Reporting Council, *The UK Corporate Governance Code* (July 2018).

¹⁰³ Ibid 4.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid 5.

may use other approaches provided they explain why the alternative arrangements are effective.

The Provision three requirements are sound and largely uncontroversial. The encompassed reporting and engagement obligations are open ended and require minimal response if the primary aim is to merely ensure compliance. Most communication between a company and the outside world will still occur at private forums with institutional investors. Boards can still determine how to engage with employees and other stakeholders, and the extent of this engagement. Moreover, boards can still decide the form and content of strategic and other forms of reporting.